Australian Government
Department of Finance

General principles for the recognition of expenditure in budget aggregates

Resource Management Guide No. 117

March 2021

ISBN: 978-1-925537-66-6 (online)

Use of the Coat of Arms

The terms under which the Coat of Arms can be used are detailed on the following website: *www.dpmc.gov.au/government/its-honour*.

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Contents

Audience

This guide is relevant to all officials in Commonwealth entities, particularly chief financial officers and finance teams, with responsibility for the presentation of Australian Government financial information.

Key points

This guide:

- outlines the principles used in the presentation of government expenditure in the:
    - Australian Government budget financial statements
    - consolidated financial statements
- replaces *Advice Paper – General principles for the recognition of expenditure in budget aggregates*, dated July 2018.

Resources

This guide is available on the Department of Finance website at *www.finance.gov.au*.

Other relevant publications include:

- Australian Accounting Standard, *AASB 1049 Whole of Government and General Government Sector Financial Reporting* (AASB 1049).

Introduction

The Australian, state and territory governments have an agreed framework for the presentation of government financial information – the *Uniform Presentation Framework* (UPF).

The UPF is based on AASB 1049, which seeks to harmonise the Australian accounting standards and government finance statistics (GFS). The key budget aggregates discussed in this guide are consistent with the UPF.

Part 1 – Key budget aggregates

The key budget aggregates presented in Australian Government financial reports are:

- **underlying cash balance** – a cash measure that shows whether the Government has to borrow from financial markets to cover its operating activities and net investments in non-financial assets used in the provision of goods and services.
- **headline cash balance** – a cash measure that shows whether the Government has to borrow from financial markets to cover its operating activities, net investments in non-financial assets used in the provision of goods and services, and net investment in financial assets for policy purposes.
- **net operating balance** – an accrual measure that shows whether the Government has to borrow from financial markets to cover its operating activities
- **fiscal balance** – an accrual measure that shows whether the Government has to borrow from financial markets to cover its operating activities and net investments in non-financial assets used in the provision of goods and services
- **net debt** – a common measure of the strength of the Government's financial position comprising liquid financial assets and interest bearing liabilities

For more information on these budget aggregates and how they are calculated, see Table 1 at Appendix 1.

Part 2 – Impact of expenditure on the key budget aggregates

This part provides information on various forms of expenditure and how these impact on the budget aggregates. For a summary of the impacts, see Table 2 at Appendix 1.

Grants

Grants are widely used to achieve Australian Government policy objectives by providing funding for service delivery, capacity building, research or infrastructure. A grant is an arrangement for the provision of financial assistance to an external recipient, including through:

- **current grants** – that fund operational spending by the recipient
- **capital grants** – that fund asset or liability transactions by the recipient.

Grants to state and territory governments include both capital and current amounts.

While the recipient controls the funding, the government may place conditions on the use of funds (e.g. specific purpose payments to the states are usually subject to conditions on how the money is spent).

The government does not receive a financial benefit in exchange for a grant. Grants increase operational expenditure and in budget aggregates:

- they have a negative impact on the underlying cash balance, headline cash balance, net operating balance and fiscal balance
- the cash spent to make the grant has a negative impact on net debt.

Purchases of non-financial assets

Non-financial assets are a store of economic value that provide benefits through their ongoing use in the provision of goods and services – which include land and buildings, infrastructure and intangibles (e.g. computer software).

Purchases of non-financial assets are capital expenditure. In budget aggregates:

- they worsen the underlying cash balance, headline cash balance and fiscal balance
- they have no impact on the net operating balance
- the cash spent to acquire the non-financial asset has a negative impact on net debt.

Prepayments for grants or purchase of goods and services

A grant or purchase of goods and services may be prepaid. A prepayment is an amount paid to the recipient before their delivery of the related goods or services.

When this occurs, the prepayment amount is recorded as a reduction in cash and a corresponding asset. In budget aggregates:

- there is no immediate impact on the net operating balance or the fiscal balance
- there is a negative impact on underlying cash balance and headline cash balance
- the reduction in cash spent to make the grant has a negative impact on net debt.

When the conditions for the grant are met or the good or service is received, the prepayment is reversed and the expense is recorded with a negative impact on the net operating balance and fiscal balance.

Public policy commercial loans

Most Australian Government loans are for public policy reasons. To establish whether:

- a public policy commercial loan exists – there must be a loan agreement on commercial terms, with an agreed repayment period and interest rate
- the full payment can be considered a loan – it must be probable that the funds will be repaid in full.

A public policy commercial loan is a financial asset transaction. In budget aggregates:

- only the interest revenue has an impact on the underlying cash balance, net operating balance, fiscal balance or net debt – a positive impact
- when a public policy loan is advanced, there is a negative impact on the headline cash balance – when it is repaid, there is a positive impact
- where there is a loan write-off by agreement with the borrower there is an expense (as the government has made a decision to reduce its loan value) and:
    - a negative impact on the net operating balance and fiscal balance
    - no impact on the current underlying cash balance or headline cash balance – because there is no cash flow associated with an expense write-off
- where there is a loan write-down or write-off, other than by agreement with the borrower:
    - there is a reduction in the value of the financial asset – the adjustment is reported as an ‘other economic flow’ in the operating statement
    - there is no impact on the underlying cash balance, headline cash balance, net operating balance or fiscal balance
    - the resulting loss of future interest has a negative impact on the future underlying cash balance, headline cash balance, net operating balance and fiscal balance.

Public policy concessional loans

A concessional loan is a loan made at a reduced interest rate, longer repayment period and/or other terms that are more favourable than commercially available. The largest concessional loan program provides financial assistance to students – see Higher Education Loan Program.

To establish whether a public policy concessional loan exists:

- there must be a loan agreement, with an agreed repayment period and interest rate
- it must be probable that the funds will be repaid in full.

The concessional expense component is the difference between the nominal value of the loan and the fair value of the market based loan component.

A public policy concessional loan is a financial asset transaction. In budget aggregates:

- the principal payments and receipts impact on the headline cash balance but not underlying cash balance
- the concessional expense has a negative impact on the net operating balance and fiscal balance at the commencement of the loan – then unwound as revenue over the loan term with a positive impact on net operating balance and fiscal balance
- only the interest revenue has an impact on the underlying cash balance, net operating balance, fiscal balance or net debt – a positive impact
- there is a negative impact on net debt – as the fair value of the concessional loan asset is lower than the amount of the loan advanced.

For the list of material government loans, see Statement of Risks reported in Budget Paper No.1.

Equity investments

An Australian Government equity investment occurs where the government becomes an owner or part owner of a business, usually through the purchase of shares in an entity outside the general government sector (such as public financial corporations, public non-financial corporations or private sector entities). Examples of equity investments include government funding of Australia Post, NBN Co and Moorebank Intermodal Company.

Most Australian Government equity investments are for public policy purposes. When the government makes equity investments, it maintains a degree of control over its investment as a shareholder, to facilitate the achievement of public policy goals and protect the investment itself.

For an investment to be fully-regarded as equity:

- the expected rate of return must be at least equal to the long-term inflation rate
- there must be a reasonable expectation that the investment will be recovered.

If these conditions are not met, the payment may be partially or fully recorded as a 'grant' expense. If the rate of return drops below the long-term inflation rate, then future payments may be classified as grants, but there is no retrospective reclassification of previous equity investments.

Equity investments are transactions in financial assets. In budget aggregates:

- equity investments have no impact on the underlying cash balance, net operating balance or fiscal balance – equity sales (such as the sale of Medibank Private) also have no impact on the underlying cash balance, net operating balance or fiscal balance
- equity investments are excluded from net debt – as they are not interest-bearing
- cash spent to fund equity investments has a negative impact on net debt
- dividends received on equity investments have a positive impact on underlying cash balance, headline cash balance, net operating balance, fiscal balance and net debt

- equity investments that are for a public policy purpose have a negative impact on the headline cash balance – the main exception is the Future Fund investment in shares for investment purposes
- any reduction in the value of an equity investment is reported as an ‘other economic flow’ in the operating statement and has no impact on the underlying cash balance, headline cash balance, net operating balance or fiscal balance
- any future reductions in dividends will negatively impact the future underlying cash balance, headline cash balance, net operating balance and fiscal balance.

The Australian Government’s investment in a public financial corporation, public non-financial corporations or private sector entity is measured at fair value in accordance with accounting standards using:

- discounted cash flows
- net assets, or
- market value of the company.

Appendix 1 – Definitions and summary of impacts

Table 1: Explanation of budget aggregates and how they are calculated

Budget aggregate	Explanation	Calculation
Underlying cash balance (UCB)	A cash measure that shows whether the Government has to borrow from financial markets to cover its operating activities and net investments in non-financial assets used in the provision of goods and services.	Net cash flows from operating activities *plus* Net cash flows from investments in non-financial assets *equals* ABS GFS cash surplus/deficit *plus* Net cash flows from financing activities for leases *equals* Underlying cash balance
Headline cash balance (HCB)	A cash measure that shows whether the Government has to borrow from financial markets to cover its operating activities, net investments in non-financial assets used in the provision of goods and services, and net investment in financial assets for policy purposes.	Underlying cash balance *plus* Net cash flows from investments in financial assets for policy purposes.
Net operating balance (NOB)	An accrual measure that shows whether the Government has to borrow from financial markets to fund its operating activities.	Total revenue from transactions *less* Total expenses from transactions
Fiscal balance (FB)	An accrual measure that shows whether the Government has to borrow from financial markets to cover its operating activities and net investments in non-financial assets used in the provision of goods and services.	Net operating balance *less* Net capital investment in non-financial assets.
Net debt	A common measure of the strength of the Government's financial position comprising liquid financial assets and interest bearing liabilities.	Sum of interest bearing liabilities *less* Sum of selected financial assets (cash and deposits, advances paid and investments, loans and placements).

Table 2: Summary of the impact of expenditure on budget aggregates

Transaction	Nature	UCB (Deficit)	HCB (Deficit)	NOB (Deficit)	FB (Deficit)	Net debt
Current grant	Non-repayable transfer.	↑	↑	↑	↑	↑
Capital grant	Non-repayable transfer.	↑	↑	↑	↑	↑
Purchase of non-financial assets	Exchange transaction.	↑	↑	–	↑	↑
Prepaid grant	Cash paid in advance and asset created.	↑	↑	–	–	↑
Prepaid purchase of good/service	Cash paid in advance and asset created.	↑	↑	–	–	↑
Public policy commercial loan	There is a loan agreement with an agreed repayment period and interest rate, and a reasonable expectation that the loan will be repaid	–	↑	–	–	–
Public policy concessional loan	There is a loan agreement with an agreed repayment period and interest rate, and a reasonable expectation that the loan will be repaid. The concession comprises a reduced interest rate, a longer repayment period and/or other terms more favourable than those in the commercial market.	–	↑	↑	↑	↑
Equity	The government has ownership interest in a non-GGS entity, where the it will earn a minimum return of long-term inflation. There is a reasonable expectation that the investment will be recovered.	–	↑	–	–	↑

↑ Increases the deficit – the arrows must be reversed for a surplus in NOB, FB, UCB or HCB.

– No impact.